No. 87-1080

Supreme Court, U.S.
FILED
JAN 28 1988
JOSEPH F. SPANIOL, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

MARYLAND NATIONAL BANK,

Appellant,

v.

STATE DEPARTMENT OF ASSESSMENTS AND TAXATION,

Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

MOTION TO DISMISS OR AFFIRM

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January 28, 1988

The Daily Record Co., Baltimore, MD 21202

COUNTER-STATEMENT OF QUESTION PRESENTED

Did Congress make Federal Home Loan Bank bonds an aberrant exception to the settled rule that States may impose a franchise tax measured by income from all sources, including otherwise tax-exempt federal obligations?

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No. 87-1080

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1987

MARYLAND NATIONAL BANK,

Appellant,

v.

STATE DEPARTMENT OF
ASSESSMENTS AND TAXATION,

Appellee.

On Appeal from the Court of Appeals of Maryland

MOTION TO DISMISS OR AFFIRM

Appellee the Maryland State Department of Assessments and Taxation hereby moves under Sup. Ct. R. 16 to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Court of Appeals of Maryland on the ground that the case presents no substantial federal question needing further

argument.

STATE STATUTE INVOLVED

Maryland imposes a franchise tax on the net earnings of financial institutions. Md. Ann. Code art. 81, § 128A. The statute requires financial institutions subject to the tax to include in their net earnings interest income from obligations of the United States, obligations of federal instrumentalities, and other sources "to the extent included in its taxable income as defined in the laws of the United States." § 128A(a)(6). Appellant Maryland National Bank ("the Bank") paid this franchise tax for the period 1979-82 and then sued for a refund of that portion of the tax reflecting interest income from Federal Home Loan Bank ("FHLB") bonds. The Bank claims that the State's franchise tax, as applied to FHLB bond income, violates the section of the Federal Home Loan Bank Act of 1932 codified

at 12 U.S.C. § 1433. Maryland's Court of Appeals unanimously rejected this argument. State Department of Assessments and Taxation v. Maryland National Bank, 310 Md. 664, 531 A.2d 294 (1987).

ARGUMENT

The Maryland Court of Appeals correctly held that the State of Maryland may consider income from Federal Home Loan Bank bonds in calculating its franchise tax on financial institutions. This unanimous ruling follows a long line of this Court's decisions upholding the power of States to impose franchise taxes measured by income from all sources, including otherwise tax-exempt federal obligations. The Court of Appeals correctly held that the Federal Home Loan Bank Act of 1932 did not create an aberrant exception to this established rule.

I. THE FEDERAL HOME LOAN BANK ACT OF 1932 DID NOT AFFECT THE STATE'S POWER TO IMPOSE FRANCHISE TAXES.

The Federal Home Loan Bank Act of 1932 created no unique exception to the accepted power of States to impose franchise taxes. The Bank relies on 12 U.S.C. § 1433, passed as part of the 1932 Federal Home Loan Bank Act, see Act of July 22, 1932, 47 Stat. 735, which provides that FHLB bonds "shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed . . . by any State . . . ." (Emphasis added.) This statute does not apply to franchise taxes, which in 1932 were unequivocally understood to be taxes on the privilege of corporate franchise, rather than taxes directly on "principal" or "interest" income.

This Court held repeatedly, both before and after passage of the 1932 FHLB Act, that

States could lawfully consider tax-exempt federal income in calculating franchise taxes.[1] This line of cases established "[t]he rule that a tax upon a franchise, measured by net income, including that from tax immune property, is not an infringement of the immunity." Pacific Co. v. Johnson, 285 U.S. 480, 490 (1932) (emphasis added).

The rule allowing franchise and other "privilege" taxes measured by otherwise tax-exempt securities resulted from this Court's then-prevailing constitutional concerns with the line between federal and state power. As this Court noted in 1931, the year before the

[1] See, e.g., Society for Savings v. Coite, 6 Wall. 594 (1868); Provident Institution for Savings v. Massachusetts, 6 Wall. 611 (1868); Home Insurance Co. v. New York, 134 U.S. 594 (1890); Educational Films Corp. v. Ward, 282 U.S. 379 (1931); Pacific Co. v. Johnson, 285 U.S. 480 (1932); Trademens National Bank v. Oklahoma Tax Commission, 309 U.S. 560 (1940); Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956) (per curiam).

Federal Home Loan Bank Act was passed, the rule's purpose was "the preservation to each government, within its own sphere, of the freedom to carry on those affairs committed to it by the Constitution, without undue interference by the other." Educational Films, 282 U.S. at 392. Among the constitutional powers committed to the states was the power to impose franchise taxes, a power the Court then held "may not be curtailed because of the indirect effect which the tax may have" on the federal government. Id. at 389 (emphasis added). The Court noted that while the "instrumentalities of either government, or the income derived from them, may not be made the direct object of taxation by the other," id. at 389, the privilege of corporate franchise was "[u]nder the Constitution the legitimate object of the state power to tax." Id. at 388. This state power was

understood to be "wholly unaffected by the fact that the corporation . . . has or has not made investment in Federal securities." Coite, 6 Wall. 594.

Statutory grants of immunity from taxation, "in derogation of a sovereign power of the state," were "strictly construed" at the time the Federal Home Loan Bank was passed. Pacific Co., 282 U.S. at 491 (1932). "Even if the construction [of such statutes] were doubtful," this Court stated, "the doubt, upon familiar principles, must be resolved in favor of the state." Id. Thus the Bank, not surprisingly, can cite no case giving a federal tax statute the construction it proposes here.

The rule allowing franchise taxes measured in part by otherwise tax-exempt income survived long after the passage of the Federal Home Loan Bank Act. The "formal but economically meaningless distinction between

taxes on government obligations and taxes on separate interests" was, in this Court's words, "'firmly embedded in the law'" until 1959, more than a quarter of a century after 12 U.S.C. § 1433 was enacted. See American Bank and Trust Co. v. Dallas County, 463 U.S. 855, 858 (1983), quoting Society for Savings v. Bowers, 349 U.S. 143, 148 (1955) (emphasis added).[2]

At the time the Federal Home Loan Bank Act became law, the universal understanding was that federal tax exemption statutes did not -- and constitutionally could not --

[2]In 1959 Congress extended the tax immunity of federal obligations "to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax." Act of Sept. 22, 1959, 73 Stat. 622, codified at 31 U.S.C. § 742. In 1982 this provision was revised and recodified as 31 U.S.C. § 3124, the statute discussed in section II infra. Act of Sept. 13, 1982, 96 Stat. 877, 945. There is no substantive difference between current section 3124 and the 1959 version of section 742. See American Bank, 463 U.S. at 859 n.1.

impair the States' power to impose franchise taxes. Nothing, either in the Federal Home Loan Bank Act or its legislative history, shows that Congress intended to depart from the rule, "applied by this court for some seventy years, that a non-discriminatory tax upon corporate franchises is valid, notwithstanding the inclusion of tax exempt . . . income in the measure of it." Educational Films, 282 U.S. at 392.[3] The Bank offers no explanation why Congress could possibly have intended a break with the decades-long recognition by this Court of the States' constitutional power to impose franchise taxes.

Even the Federal Home Loan Bank Board

[3]Evaluation of congressional action must of course "take into account its contemporary legal context." Cannon v. University of Chicago, 441 U.S. 677, 698-99 (1979). The presumption is that Congress was aware of this Court's settled decisions and intended no departure from them. Id.; see also Shapiro v. United States, 335 U.S. 1, 16 (1948).

itself has not claimed the peculiar tax immunity for its bonds that the Bank claims here. Thus in an opinion of January 13, 1976, the Office of General Counsel for the Federal Home Loan Bank Board concluded that there was no legal impediment to the inclusion of FHLB stock in income for purposes of calculating Florida's franchise tax. This opinion was based on this Court's many decisions enunciating the "distinction between a direct tax upon net income and an excise or franchise tax measured by net income." Letter of January 13, 1976, quoted in Maryland National, 310 Md. at 675, 531 A.2d at 299-300 (App. at 12a).

The Bank's reading of the 1932 Federal Home Loan Bank Act also collides with a 1926 statute that specifically authorized state franchise taxes on national banks measured by "the entire net income received from all sources." See Act of Mar. 25, 1926, 44 Stat.

223, codified at 12 U.S.C. § 548(c) (amended 1969) (emphasis added). "The plain meaning of [this 1926 provision] is confirmed by its legislative history showing beyond doubt that Congress intended to authorize a franchise tax measured by net income including interest on tax-immune federal securities." Tradesmens National Bank, 309 U.S. at 563-64. Reading the 1932 FHLB Act to bar franchise taxes from considering FHLB bond income would have partially revoked the State's power under this 1926 provision to consider the Bank's "entire net income received from all sources." Statutory interpretations that would require such implicit repeals "are not favored." Posadas v. National City Bank, 296 U.S. 497, 503 (1936). The Bank does not address this 1926 statute in its jurisdictional statement.

The Bank's argument, notwithstanding this Court's settled precedent and statutes

to the contrary, is that in 1932 Congress must have intended to create a tax immunity from franchise taxes in section 1433. Otherwise, the Bank reasons, section 1433's parenthetical listing of other "privilege" taxes as exceptions to the FHLB bond tax immunity would be "surplusage." Jurisdictional Statement at 10-16. The idea that a list of exclusions should be read as exhaustive, however, is "but an aid to construction" rather than an inflexible rule of law. S.E.C. v. C.M. Joiner Leasing Corp. 320 U.S. 344, 351 n.8 (1943). This Court does not allow such an aid to construction to defeat congressional intent, see Herman & MacLean v. Huddleston, 459 U.S. 375, 387 n.23 (1983), an elementary principle the Bank studiously ignores.

Section 1433 does not apply to franchise taxes. For this reason alone the Bank's entire appeal must fail, and the Court need

not even reach the issues raised in section II below.

II. CONGRESS HAS AUTHORIZED STATES TO CONSIDER FEDERAL OBLIGATIONS, SUCH AS FEDERAL HOME LOAN BANK BONDS, FOR FRANCHISE TAX PURPOSES.

Congress has reaffirmed the states' power to impose franchise taxes measured by otherwise tax-exempt federal obligations in 31 U.S.C. § 3124. Section 3124 provides that "obligations of the United States Government are exempt from . . . each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax." An express exception to this immunity is made for a "nondiscriminatory franchise tax . . . imposed on a corporation." § 3124(a)(1).

Section 3124 covers FHLB obligations. This Court has established that section 3124 (as earlier codified at 31 U.S.C. § 742) applies not only to treasury obligations, but

also "to written interest-bearing obligations issued pursuant to Congressional authorization." Smith v. Davis, 323 U.S. 111, 116 (1944). Thus the provision also applies "to the obligations of such instrumentalities of the United States as Federal Farm Credit Banks." Memphis Bank & Trust Co. v. Garner, 459 U.S. 392, 396 (1983). Federal Home Loan Banks, like Federal Farm Credit Banks, are federal instrumentalities created by Congress so that the United States can secure necessary credit. See, e.g., Fahey v. O'Melveny & Myers, 200 F.2d 420, 446 (9th Cir. 1952). Indeed, Federal Home Loan Banks are denominated as federal instrumentalities in the FHLB statute itself. See 12 U.S.C. § 1431(e)(1) (referring to Federal Home Loan Bank "or other instrumentality of the United States"). The obligations of this federal instrumentality are therefore covered by the same tax immunity, section 3124, that governs

all other federally issued obligations.[4]

The Bank now contends that whether section 3124 applies is a "substantial" federal question. Jurisdictional Statement at 10. Below, however, the Bank deemed this argument worth little more than a page of its 45-page brief before the Maryland Court of Appeals. See Brief of Appellee/Cross-Appellant at 32-33. The Bank's argument is that section 3124 does not cover FHLB bonds because part of the 1932 Federal Home Loan Bank Act provides that FHLB obligations "shall plainly state that such obligations are not obligations of the United States and

[4]FHLB obligations therefore differ from obligations for which "[t]he issuer of the certificate is a private party." Rockford Life Insurance Co. v. Illinois Department of Revenue, __U.S.__, 107 S. Ct. 2312, 2315 (1987) (holding that section 3124 does not apply to obligations guaranteed but not issued by a federal agency, the Government National Mortgage Association). FHLB bonds are the direct and primary obligation of the Federal Home Loan Banks. 12 U.S.C. § 1431(c).

are not guaranteed by the United States." 12 U.S.C. § 1435. This provision, however, clearly has nothing to do with taxes. Congress added this language to the Federal Home Loan Bank Act simply to avoid the mistaken belief, existing among investors in the bonds of federal land-banks, that the federal government and not just its instrumentalities guaranteed those bonds. See 75 Cong. Rec. 14452, 14582-83 (1932).

"The adventitious occurrence of like or similar phrases . . . in laws enacted for wholly different ends" does not justify construing those laws together. State v. DiCarlo, 338 A.2d 809, 811 (N.J. 1975). To rule otherwise would lead to the bizarre result that cash -- also referred to as "obligations of the United States" under a statute authorizing the issuance of currency -- would be immune from direct State taxation under section 3124. See 12 U.S.C. § 411;

Provenza v. Comptroller of the Treasury, 64 Md. App. 563, 497 A.2d 831 (1985) (pro se taxpayer argument for such a result rejected). Here, as in Provenza, the happenstance of similar phrases in unrelated statutes does not dictate an otherwise unsupported reading of federal law.

CONCLUSION

This Court should dismiss the above-captioned appeal or in the alternative affirm the unanimous decision of the Maryland Court of Appeals for the reasons stated above.

Respectfully submitted,

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